NO. 85-568 (17)

IN THE

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLEES' BRIEF

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QUESTIONS PRESENTED

1. Is federal preemption mandated under the Federal Power Act where a State's utilities commission sets fair and reasonable intrastate retail rates using an accounting method (roll-in) which recognizes all relevant costs, in order to reach the resulting fair and reasonable retail rates and where the utility company's parent company (Alcoa) has left the utility company "...an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina"?

2. May the Commerce Clause of the Constitution of the United Stated be successfully invoked by a parent utility company to block a State's utility commission from utilizing an accounting method (roll-in) to achieve fair and reasonable intrastate retail rates for the captive company (Nantahala) and the using and consuming public of North Carolina when the methodology does not allocate or interfere with the interstate flow of electric power?

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OPINIONS BELOW

Appellants' discussion of the central issue of federal preemption is incomplete without reference to the companion Nantahala wholesale cases at the Federal Energy Regulatory Commission ("FERC"). The relevant decisions are: (1) FERC Opinion 139 in Docket Nos. ER 76-828-000 and EL 78-18-000, issued May 14, 1982 (19 F.E.R.C. §61,152); (2) FERC Opinion 139-A in the same Dockets, issued September 30, 1982 (20 F.E.R.C. §61,430); and (3) the Opinion of the United States Court of Appeals for the Fourth Circuit in *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342 (4th Cir. 1984). Appellants printed only excerpts from Opinions 139 and 139-A in their Appendix to the Jurisdictional Statement ("A.J.S."), and omitted the Fourth Circuit's opinion. Hence, Appellees have filed 18 copies of the FERC and 4th Circuit Opinions with the Court.

STATUTORY PROVISIONS

1. N.C. Gen. Stat. §62-3(23)c. Definitions [of Public Utilities].

2. N.C. Gen. Stat. §62-133(b). How [utility] rates fixed. (Both sections set forth in full text in Appendix hereto.)

STATEMENT OF THE CASE

1. Appellants' Statement Of The Case Contains Factual Errors And Is Otherwise Misleading.

Appellants' factual errors and misstatements are so pervasive that, effectively, they argue a phantom Case on Appeal which has been rejected by every court which has fully reviewed the facts and law involved in this unique situation. We call attention only to seven basic errors which appear in the Appellants' Statement of the Case. These are:

(1) The North Carolina Utilities Commission ("NCUC") refused to give effect to FERC-approved rate schedules (Appellants' Brief or "Brief", pp. 4, 10, 14, 15);

(2) The NCUC made independent determinations of the reasonableness of interstate cost and power allocations (Brief, pp. 9, 14);

(3) The NCUC assigned more low cost power to Nantahala Power and Light Company ("Nantahala") than the FERC. (Brief, pp. 10, 14);

(4) The 1971 Nantahala-Tapoco Apportionment Agreement ("1971 Agreement") allocates power between North Carolina and Tennessee (Brief, p. 5);

(5) Tennessee receives only such power as is left after allocation of power to Nantahala (Brief, p. 14);

(6) The Alcoa refund requirement was due to Alcoa's capacity as a resident of Tennessee or as a customer of Tapoco (Brief, p. 15); and

(7) The roll-in methodology gives North Carolina retail customers a "first call" preference to the hydroelectric power (Brief, p. 11).

2. Appellees' Statement Of The Case Actually Tried and Decided Below.

This case involves the setting of intrastate retail electric rates for customers of Nantahala. All parties concede such rates are subject to the exclusive jurisdiction of the NCUC. After conducting extensive hearings, the NCUC determined fair and reasonable retail rates for both Nantahala and the North Carolina retail customers. In fixing such rates, the NCUC was aware of Nantahala's total domination by its parent, the Aluminum Company of America (Alcoa), as well as Alcoa's total domination over Tapoco, Inc. (Tapoco), Nantahala's sister company. Nantahala and Tapoco are wholly-owned subsidiaries of Alcoa (collectively referred to at times as the "Alcoa Power System"). Alcoa's control had been exercised for Alcoa's benefit to the detriment of both Nantahala, alone, and the North Carolina retail customers. The NCUC was aware of Alcoa's repeated attempts (See, e.g., A.J.S., pp. 19a-32a and footnotes 5 and 10) to frustrate state and federal efforts: (a) to effectively regulate the Alcoa Power System; (b) to prevent Alcoa from granting unlawful preferences to itself as a customer of the system; and, (c) to prevent Alcoa's further efforts to remove from the public domain hydroelectric resources which were licensed to serve the needs of the consuming public.

In late 1976, Nantahala filed an application before the NCUC for an increase of $1,830,791 in its retail electric rates. The Nantahala and Tapoco plants and facilities are located adjacent to and are physically interconnected with each other. Nantahala's total plant is in North Carolina while Tapoco's plant is partially in North Carolina and partially in Tennessee. Both are North

Carolina public utility companies and both hold certificates of convenience and necessity in North Carolina to serve the using and consuming public.

With notice to Alcoa and Tapoco, and after initial hearings fully participated in by them, the NCUC determined that they were North Carolina public utilities and proper parties to the cause (R., Vol. I, pp. 76-88).

Central to this case are two agreements: the 1962 New Fontana Agreement ("NFA") and the 1971 Apportionment Agreement ("1971 Agreement").

1. The NFA (Ex. Vol. 1, Item 40, New Fontana Agreement), was a contract between Nantahala, Tapoco, and Alcoa, on the one hand, and the Tennessee Valley Authority ("TVA") on the other, by the terms of which Nantahala and Tapoco turned over, at generation, virtually all of their power[1] to TVA and received, in return from TVA, power of a finite quantity to be divided among the three companies as Alcoa decided. Under this Agreement, Nantahala and Tapoco are treated as a combined power system. The NFA did not establish the power costs of the individual companies and is merely a power exchange (i.e. barter) agreement. Although not a typical 'sale' of power, the NFA is, nonetheless, a "rate schedule" which was "filed" at FERC in 1966, some four years after its execution.

2. The 1971 Agreement was a contract imposed upon Nantahala and Tapoco by Alcoa to divide the return power entitlements from TVA under the NFA. The 1971 Agreement did not, in and of itself, establish power costs of either Nantahala or Tapoco for wholesale or retail ratemaking purposes (Ex. Vol. 4, Item 29, A. G. Jontz Cross Exam Ex. 3). FERC found this Agreement to be unfair and unreasonable as to Nantahala (A.J.S. pp. 281a, 290a, 293a) and did not follow it in establishing Nantahala's wholesale rates (A.J.S. p. 275a approved by Opinion 139, A.J.S. pp. 284a-301a). FERC also found this Agreement does not constitute a "sale" of power between Nantahala and Tapoco (A.J.S. p. 292a).

[1]Tapoco turned over all of the power generated at its four dams, while Nantahala turned over all of the power from its eight principal dams. Power from Nantahala's three smallest, run-of-the-river facilities was kept by Nantahala. The total output of Nantahala's eleven dams was, and is, only about one-quarter of the output of Tapoco's four dams.

The NCUC conducted extensive general rate case hearings, in which all parties offered considerable evidence concerning, *inter alia*, the NFA and 1971 Agreement together with evidence as to the use and effect of the roll-in methodology.

On September 2, 1981, the NCUC entered its order (A.J.S. pp. 165a-235a) implementing roll-in based upon findings that: (1) Tapoco is a North Carolina public utility; (2) Tapoco and Nantahala operate a single, unified electric public utility system; (3) Pursuant to N. C. Gen. Stat. §62-3(23)c, Alcoa, the 100% parent of Nantahala and Tapoco, is a North Carolina public utility to the extent of its effect on Nantahala's retail rates and services; and (4) Alcoa has dominated Nantahala for its own benefit, to the detriment of Nantahala and its retail ratepayers.[2]

Having determined that Tapoco was a North Carolina public utility[3] and that Tapoco and Nantahala operate a single, integrated electric public utility system, the NCUC: (a) joined the 1975 test year assets, properties, plants, working capital requirements, etc., of the two companies, into one unified rate base (A.J.S. pp. 176a-177a); (b) totaled the test year revenues of the companies (A.J.S. p. 177a); (c) totaled the test year operating expenses of the companies (A.J.S. p. 177a); and (d) assigned one rate of return to the total rate base assets of the two companies[4] (A.J.S. p. 178a).

[2]All of these facts have been established by substantial competent evidence and upheld on appeal. Appellants do not contest them in this Court. *Herb v. Pitcairn*, 324 U.S. 117, 125-126 (1954).

[3]Tapoco, as Nantahala's sister corporation, is 100% owned by Alcoa (A.J.S. p. 175a). Tapoco functions solely as the Power Supply Department of Alcoa's Tennessee Operations and Alcoa buys Tapoco's power at a price "...totally unrelated to the true value of the Tapoco energy actually received by Alcoa." *Utilities Commission v. Edmisten*, 299 N.C. 432, 439, fn 4; 263 S.E.2d 583 (1980).

[4]The Nantahala rate of return was used since Tapoco is less risky than Nantahala.

From these elements, the single system revenue requirement [reasonable operating expenses plus (rate base X rate of return)] was derived as required by N.C.Gen. Stat. §62-133(b) (set forth in full in Appendix). The single system's cost of service was then allocated between the respective loads which it served (A.J.S. p. 222a).[5] This is all that "roll-in" methodology means.

The level of Nantahala "stand-alone" book costs were not considered appropriate as the sole basis for cost allocation purposes because: (1) Nantahala was not a "stand-alone" company; (2) Nantahala - Tapoco is physically a single, integrated system of hydroelectric power generation, although they are separate corporations; (3) neither the NFA nor the 1971 Agreement was a cost allocation Agreement; and (4) neither Agreement could be used for cost allocations of a single Nantahala/Tapoco system.

The NCUC found . . 24.6% of the *demand* costs and 24.51% of the *energy* costs (A.J... p. 221a) of the single system should be allocated to Nantahala's retail cost of service[6] (A.J.S. p. 221a). These are actual, not assumed, capacity and energy calculations.

Because the Nantahala-Tapoco single system's average costs are lower than the costs for Nantahala viewed as a "stand alone" company (A.J.S. p. 293a), which it was not designed to be (A.J.S. p. 181a), use of the roll-in methodology reduced Nantahala's annual revenue requirements by about $4,500,000 below the level indicated if Nantahala had been treated as a "stand alone" company for retail rate purposes.

[5]The NCUC make he same kind of allocation in setting rates for other interstate companies, such as Duke Power and Carolina Power and Light, which operate in more than one state.

[6]"Electric rates are generally based on the cost of rendering service." Many rate schedules consist of two parts, a demand charge and an energy charge...The *demand* component of the rate schedule is devised to provide for the expenses incident to furnishing facilities and plant to meet customer demand. The *energy* component is designed to meet fuel costs for generating current and day to day operating expenses." *Utilities Commission vs. Area Development, Inc.*, 257 N.C. 560, 562; 126 S.E.2d 325 (1962).

Alcoa is present in the case because "... [I]n essence, Alcoa was found to have been a 'public utility' having an effect on Nantahala's rates and services for many years. Based upon this finding and upon the Commission's findings of detrimental domination,[7] Alcoa can properly be held to pay any refunds[8] Nantahala is ordered to pay in this proceeding, but is unable to satisfy out of its own financial resources ..."[9] Upon appeal by the Companies of the NCUC orders, the North Carolina Court of Appeals and the North Carolina Supreme Court affirmed all relevant findings.

Alcoa and Tapoco (but not Nantahala) filed a complaint in the United States District Court, seeking to enjoin the NCUC's actions. The District Court dismissed on abstention grounds. On appeal by Alcoa, the Fourth Circuit affirmed[10] noting the NCUC order "...on its face sets only retail, intrastate rates, an important matter traditionally within the sole discretion of the states, and does not directly conflict with FERC's wholesale and interstate rate setting power."[11]

Every court which has reviewed the facts and applicable law, in this novel and unique fact situation, has rejected Alcoa's attempts to *avoid regulation* and to *federalize* its unreasonable and publicly detrimental conduct in controlling the Nantahala-Tapoco hydroelectric power system for its own purposes.

[7]"Alcoa has so dominated these transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina...(A.J.S. p. 233a).

[8]Nantahala's initial refund plan was rejected and Nantahala and Alcoa were required to file a joint refund plan (R. Vol. II, pp. 322-326). Alcoa declined to participate in a plan to divide the refund obligation between Alcoa and Nantahala (R. Vol. II, pp. 354-356). The NCUC was ultimately forced to adopt its own refund plan (R. Vol. II, pp. 377-381). At simple interest the amount of refund now due is approximately thirty million dollars.

[9]*Utilities Commission v. Edmisten*, 313 N.C. 614, 737; 332 S.E. 2d 397 (1985).

[10]*Aluminum Company of America v. Utilities Commission*, 713 F. 2d 1024 (4th Cir., 1983); *cert. denied* 104 S.Ct. 1326 (1984).

[11]Footnote 10, *Id.*, 713 F.2d at 1030.

The NCUC's orders do not: (l) disregard FERC-approved power allocations or agreements; (2) assign to Nantahala more low cost power than FERC did; (3) allocate any costs to Tapoco, much less to Tapoco's customer Alcoa; or, (4) require that Tennessee receive only the amount of power left after allocation of power to Nantahala. The roll-in only allocated Nantahala's intrastate retail costs by an accounting method used to accurately reflect the Nantahala retail customers cost responsibility portion of the Nantahala-Tapoco single system. Roll-in does not affect any power flows to TVA, Tapoco, Nantahala or Alcoa.[12]

While the NCUC Order states that the North Carolina retail customers should be given a "first call" on the North Carolina-produced hydroelectric power (A.J.S. p. 183a), the North Carolina Supreme Court, in review, determined that the "first call" language in the NCUC Order was not what the roll-in, in fact, accomplished (A.J.S., pp. 10la-103a). In fact, nowhere in the NCUC order do North Carolina customers receive a preference of hydroelectric power over Tennessee's customer. For Appellants to advance the "first call" preference proposition is disingenuous and bottomed upon the proposition this Court will not grasp the true situation.[13]

[12]"This device does nothing more than recognize that the two corporate entities ought, for rate making accounting purposes, be treated as the one electrical power producing and distribution system which, in fact, they are." *Utilities Commission v. Edmisten*, 299 N.C. 432, 443; 263 S.E.2d 583 (1980).

[13]The "first call" idea comes from a single witness's testimony based upon a hypothetical question. The question was whether the witness's method of cost allocations, *using a hypothetical replacement for the NFA*, designed to reflect a fair treatment of the public load, would be different than his actual allocations, *based upon the existing NFA*. In response to this hypothetical, he answered "yes", that in such event *he would give* the public load "first call" (Tr. Vol. 15, pp. 65-66). That answer does not relate to the roll-in methodology actually employed by the witness or adopted by the NCUC.

3. *The Related FERC Cases.*

On July 30, 1976, Nantahala filed a wholesale rate case in FERC Docket ER 76-828, seeking to increase its wholesale rates, affecting three wholesale customers, by the annual amount of $121,908 (A.J.S. p. 269a), which was consolidated for hearing with a complaint proceeding instituted by one of Nantahala's wholesale customers (Docket EL 78-18).

An initial decision was rendered by the Administrative Law Judge ("ALJ")[14] on April 10, 1981 who refused to set Nantahala's wholesale rates on the basis of the NFA and the 1971 Agreement. He also declined to "pierce the corporate veil" between Alcoa and Nantahala or to apply a roll-in methodology for wholesale ratemaking, because:

> ...a more appropriate relief is available. This relief is to set rates for Nantahala *as if* the 1971 Apportionment Agreement were reformed to reflect a fair allocation of power and energy to Nantahala (A.J.S. p.275a), (Emphasis supplied).

On review, FERC also declined to fix Nantahala's wholesale rates based upon the power allocations provided by the NFA and the 1971 Agreement. Instead, FERC set Nantahala's wholesale rates by hypothetically allocating to Nantahala 44 million kwh of annual power to which Nantahala was not entitled under the 1971 Agreement. This allocation was a substantial deviation from the FERC filed rates. The FERC stated that its decision would set just and reasonable rates for Nantahala to charge its wholesale customers (A.J.S. p. 312a). In its No. 139 Opinion, FERC did not allocate power as between North Carolina and Tennessee, nor did FERC allocate the cost of power for purposes of retail ratemaking. In Docket No. ER 81-19-000 (A.J.S. pp. 262a-266a), it is clear that FERC did not accept the 1971 Agreement for any allocation purpose. The Agreement itself divides power, but not

[14]The hearing judge, Graham McGowan, retired (and died), and Jacob Leventhal issued the initial decision. Excerpts of Judge Leventhal's opinion are printed on pp. 267a-282a of the A.J.S.

costs (Ex. Vol. 4, Item 29, A. G. Jontz Cross Exam. Ex. 3), particularly not the costs of a single system. Indeed, as stated in the ER 81-19 order, Tapoco argued that the Agreement set neither rates nor charges (A.J.S. p. 264a). When the FERC subsequently set Nantahala's wholesale rates in Docket Nos. ER 76-828 and EL 78-18, it did not follow the 1971 Agreement for purposes of cost allocation. *FERC did not provide any actual additional power to Nantahala. FERC did not increase or lessen the power actually received by TVA, Alcoa, Nantahala or Tapoco and did not modify Tapoco's FERC (Alcoa) rates, the NFA, or Tapoco's actual sales to Alcoa. As to Nantahala, Tapoco, Alcoa and TVA, there was absolutely no change in the power which flowed or the costs incurred under the FERC-filed rate schedules.* The only thing FERC did was to adjust Nantahala's wholesale costs as if Nantahala had received additional power (App. pp. 293, 295a-296a).

SUMMARY OF ARGUMENT

1. The NCUC'S Orders Do Not Violate The Preemption Doctrine.

The facts of this case are unique in the electric power industry. The NCUC made four essential findings of fact: (1) Tapoco is a North Carolina public utility; (2) Alcoa is a North Carolina public utility; (3) the plants and facilities of Tapoco and Nantahala form a single, integrated electric system, and (4) Alcoa has so dominated Nantahala that Nantahala is unable to protect itself, much less its retail customers. The NCUC's roll-in methodology follows as a natural consequence of these findings.

FERC found that the 1971 Agreement was unfair to Nantahala and did not consider itself bound by the 1971 Agreement in setting Nantahala's wholesale rates. Accordingly, the NCUC's roll-in is not subject to preemption for at least five reasons in addition to the unique facts of this case.

First, the FERC itself, in Docket Nos. ER 76-828 and EL 78-18, set Nantahala's wholesale rates by theoretically assigning power to Nantahala without reforming the 1971 Agreement. Under

the "filed rates" doctrine, FERC, in setting rates fair and reasonable under Section 205 of the Federal Power Act, is as bound by agreements accepted for filing as is a state's utility commission in setting fair and reasonable retail rates. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577-578 (1981). Neither sovereign can surrender its obligation to protect the public from unjust, unfair and unreasonable rates. The federal preemption doctrine does not require such a result.

Second, the 1971 Agreement, at most, merely divided the TVA return power entitlements between Nantahala and Tapoco. It did not apportion costs, particularly not the costs of the single Nantahala-Tapoco system. The NFA is totally silent with respect to the allocation of either power or costs.

Third, Federal and State regulatory commissions can adopt different ratemaking methodologies which result in fair, just and reasonable rates at both wholesale and retail levels. 16 U.S.C. §823(e)(1); *Mid-Tex Electric Cooperative, Inc. v. FERC*, 773 F.2d 327 (D.C. Cir., 1985).[15] In its Opinions 139 and 139-A, FERC recognized that it was not bound by the NCUC's use of the roll-in or the NCUC's findings that Nantahala/Tapoco constitute a single system and that Tapoco was a North Carolina public utility. The converse of that proposition is also true.

Fourth, the *Narragansett/Northern States* line of cases is inapplicable to this current case because, in those cases, the State commissions attempted either to avoid passing on to retail ratepayers a FERC-approved cost or to reallocate a cost which FERC had specifically and directly allocated to a state or a retail utility company. In this case, all relevant costs were recognized; none were excluded; and no costs specifically allocated by FERC were reallocated, with the result that the current case is outside of the *Narragansett/Northern States* line of cases.

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[15]For example, the states are free to accept FERC's Uniform System of Accounts or they may require their own separate accounting system. 16 U.S.C. §825(a). See also 16 U.S.C. §§824b(a), 824c(a) and 824g for other examples where state methodologies may differ from FERC's. Also, see *Jersey Central Power and Light Co. v. FPC*, 319 U.S. 61, 74-75 (1943).

Fifth, a developing line of cases, epitomized by ***Public Service Co. of Colorado v. Public Utilities Comm. of Colorado***, 644 P.2d 933 (Colo. 1982), recognizes that the preemption doctrine does not preclude a state utility commission from determining whether certain FERC-approved costs are to be borne by the retail ratepayers or the stockholders.

2. The NCUC'S Orders Do Not Violate The Commerce Clause.

The roll-in neither diverted, directly or indirectly, any power from Tapoco/Alcoa to Nantahala nor created a preference for North Carolina ratepayers. Thus, there was no intrusion upon interstate commerce so as to constitute a violation of the Commerce Clause of the United States Constitution. The preference prohibition of *New England Power Company v. New Hampshire*, 455 U.S. 331 (1982) (hereafter, "NEPCO") is not applicable. The roll-in was not implemented to create a preference for North Carolina; instead, its sole purpose was to set just and reasonable retail electric rates for an Alcoa subsidiary which was dominated by Alcoa for Alcoa's benefit and to the retail ratepayers' detriment. The roll-in is the least intrusive retail ratemaking method available to protect the retail using and consuming public from unjust and unreasonable rates.

Any economic benefit arguably favoring North Carolina retail ratepayers flowed from an evenhanded regulation of a legitimate local public interest and placed only an indirect, incidental burden (if any) on interstate commerce. This result is clearly permissible under the test this Court laid down in *Pike v. Bruce Church*, 397 U.S. 137 (1970).

ARGUMENT

Introduction

The constitutional principles of preemption, in whatever particular field of law they operate, are designed with a common

end in view to avoid conflicting regulation of conduct by various official bodies which might have some authority over the subject matter. *Amalgamated Assn. of Street, Electric Ry. & Motor Coach Employees v. Lockridge*, 403 U.S. 274, 285-286 (1971). In the final analysis, there can be no one crystal clear distinctly marked formula. The Court's primary function is to determine whether, under the circumstances of this particular case, the NCUC's order stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Justice Brennan wrote: "The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons - either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Florida Lime & Avocado Growers v. Paul*, 373 U.S. 132, 142 (1963).

The facts of this case are unique in the electric power industry.[16] Nantahala is simply not like or comparable to Narragansett Electric Company. The Nantahala-Tapoco single system is not like or comparable to Northern States Power Company or other electric holding company systems, such as Middle South Utilities, the Southern Companies System or the American Electric Power System. Thus, while Appellees have no quarrel with the general principles enunciated in Appellants' Supremacy Clause and Commerce Clause cases, such principles have no relevance to the case at bar, because the instant facts are so dramatically different from the facts of the cases relied upon by Appellants. Moreover, none of the cases relied upon by Appellants and their allies involve FERC-filed agreements that: (a) were found to be unfair by the FERC, (b) did not allocate costs between wholesale and resale customers, and (c) were not followed by the FERC itself in setting wholesale rates.

In all of these cases, the State utility commissions clearly interfered with FERC-approved power and cost allocations, which the NCUC did not do. In no other case relied upon by Appellants

[16] For summary of relevant facts see: A.J.S. pp. 13a, 32a, 166a-235a.

is the parent corporation engaged in a principal manufacturing business which is separate and apart from the production, transmission and distribution of electric power. In no other case is the parent, in its separate manufacturing operations, the largest (by far) customer of its own power system. In no other case has the parent been caught awarding unlawful preferences and benefits to itself, *Utilities Commission v. Mead Corporation*, 238 N.C. 451; 78 S.E. 2d 290 (1953. The veil of corporate separateness between parent and subsidiaries has not been pierced in most of these cases. In no other case is there a consistent history of the parent attempting to remove resources dedicated to the public's service from the public domain, for its own sole, private and exclusive use. *Utilities Commission v. Membership Corporation*, 260 N.C. 59; 131 S.E. 2d 865 (1963).

I. THE PREEMPTION (FILED RATES) DOCTRINE, DOES NOT PRECLUDE THE NCUC FROM SETTING NANTAHALA'S RETAIL RATES USING A ROLL-IN METHODOLOGY.

A. Analysis Of The Federal Power Act And The Narragansett/Northern States Line Of Cases Clearly Shows That The Preemption (Filed Rate) Doctrine Is Not Applicable To The Current Case.

A long line of cases has laid down the "filed rate" doctrine, recognizing the FERC's exclusive right to pass upon certain matters affecting wholesale electric rates and the interstate transmission of electricity, so as to preclude inconsistent state action. As a necessary adjunct to the 'bright line' test established in *FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964), *(Colton)*, whenever the FERC has accepted for filing and approved wholesale rates of a FERC-jurisdictional utility, state regulatory commissions may not conduct their own independent investigation concerning the reasonableness of the wholesale rate *so as to interfere with the filed rate.* Under the *Colton* rule, the FERC, pursuant to Article VI, Clause 2 of the United States Constitution and the Federal Power Act (16 U.S.C. 791a-828c), has the exclusive right to set wholesale, interstate power rates for its

jurisdictional utilities. Appellees fully accept the "bright line" doctrine as stated in the *Colton* case. It necessarily follows that, while the state commissions may not cross the "bright line" and interfere with FERC's wholesale, interstate ratemaking authority, FERC is equally forbidden to cross the "bright line" so as to interfere with the rights of state commissions to set the just and reasonable level of retail rates and charges for intrastate utility service.[17]

Since this Court first announced the "bright line" rule in *Colton*, virtually all of the leading cases concerning federal preemption have been decided at the State level. In *Narragansett Electric Co. v. Burke*, 119 R.I. 559; 381 A.2d 1358 (1977), *cert. denied* 435 U.S. 972 (1978), the Rhode Island Commission engaged in a searching inquiry into a wholesale supplier's *costs* and concluded that the wholesale rates charged to and paid by a local utility for purchased power were unreasonable. The State Supreme Court decreed that the Commission's action violated the wholesale rate structure on file with and approved by FERC. A similar filed rate violation was found in *United Gas Corp. v. Mississippi Public Service Commission*, 240 Miss. 405; 127 So. 2d 404 (1961), where the Mississippi Commission refused to allow in retail rates certain wholesale purchased gas *costs* which it found to be unreasonable. In *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 607; 150 N. E. 2d 776, 780-81 (1958) and *Citizens Gas Users Assoc. v. Public Utilities Commission of Ohio*, 165 Ohio 536; 138 N.E. 2d 383 (1956) the respective courts held that state commissions could not disallow, from retail operating expenses, the *cost* of gas purchased at wholesale under FPC jurisdictional tariffs. The filed rates doctrine was also applied to reverse a state commission's order disallowing FERC-approved *costs* in *Office of Public Counselor v. Indiana & Michigan Electric Co.*, 416 N.E. 2d 161 (Ind. App. 1981). In that case, the Indiana commission consolidated a retail electric utility and a wholly-owned nuclear subsidiary in order to set a single rate of return for the rolled-in assets. The intended result of the Indiana Commission was to eliminate the higher rate of return fixed for the subsidiary by FERC. In *Northern States Power Co. v. Minnesota Public Utilities*

[17]16 U.S.C. §824a (Section 201(a), Federal Power Act). See, Senate Rep. No. 621, 74th Cong., 1st Sess., "Public Utility Act of 1935", p. 18.

Commission, 344 N.W. 2d 374 (Minn. 1983); *cert. denied* 104 S.Ct. 3546 (1984) and *Northern States Power Co. v. Hagen*, 314 N.W. 2d 32 (N.D. 1981), where affiliated utilities allocated canceled nuclear plant *costs* between themselves by means of a FERC-approved wholesale bulk power sales contract, it was held that the state commissions could not set the retail rates of these utilities so as to alter or interfere with the FERC's cost allocation. In *Eastern Edison Co. v. Department of Public Utilities*, 388 Mass. 292; 446 N. E. 2d 684 (1983), the state commission was likewise prohibited from disallowing abandoned nuclear plant *costs* which were included in the FERC-approved wholesale rates paid by the retail utility.

All of these cases are clearly distinguishable from the current case in that, in each case, the various state commissions attempted to disallow actual *costs* arising from and allocated by the FERC filed and approved rates. In the roll-in scenario of the current case, each and every item of *cost* arising from the NFA and the 1971 Agreement was recognized and allowed in the roll-in. Not a single *cost* was excluded. By the roll-in, all relevant *costs* of power arising from the various contracts were placed into the single system pot of *costs* and were allocated to the appropriate customer loads.

The North Carolina Supreme Court further rejected the Companies' reliance on the filed rate doctrine as stated in the foregoing cases by also noting that the Companies'

> ...arguments rest upon the faulty premise that FERC deemed both the NFA and the 1971 Apportionment Agreement to be fair and reasonable to Nantahala, when in fact it [FERC] expressly ruled that the latter agreement was "unfair" and refused to permit Nantahala to base its requested wholesale rate increase upon the costs incurred thereunder (313 N.C. at 693).

The NCUC's ~~roll-in~~ is far removed from the scope of the filed rate doctrine enunciated by the *Narragansett/Northern States* line of cases. In those cases, the FERC had approved, as fair and

reasonable, the allocation of costs associated with the various rates or agreements. However, in the current case, the FERC expressly found that the 1971 Agreement was unfair.

The controlling facts of the present case are dramatically different from the facts in any of the *Narragansett/Northern States* line of cases.[18] As previously noted, Nantahala is not like Narragansett Power Company. The Nantahala/Tapoco single system is not like the Northern States Power Companies, Middle-South Utilities or the American Electric Power System. In none of the *Narragansett/Northern States* cases was the state commission compelled to pierce the corporate veil because of the parent's long history of domination and self-dealing for its own benefit.

1. *The FERC, In Setting Nantahala's Wholesale Rates, Did Not Follow The Filed Rate Doctrine.*

FERC is authorized to fix and establish just and reasonable wholesale rates under Section 205 of the Federal Power Act ("the Act"). FERC is no less bound by filed or approved power agreements than is a state commission in the latter's setting of retail rates. In litigation involving the Natural Gas Act,[19] this Court stated the reasons for this proposition as follows:

[18]The Appellees are aware of this Court's recent decision in *Transcontinental Gas Pipeline Corp. v. Oil and Gas Board, et al.*, ________ U.S. ________, Case No. 84-1076, 54 Law Week 4114 (January 22, 1986). While that case involved an interpretation of the Natural Gas Act and the Natural Gas Policy Act of 1978, the Natural Gas Act and the Federal Power Act are frequently used interchangeably, *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). Nevertheless, the *Transcontinental* case adds nothing of substance to the filed rate doctrine of preemption previously discussed and is even further apart from the unique facts of this case than the *Narragansett/Northern States* line of cases. In contrast to this case, the Mississippi regulation (state action) in *Transcontinental* directly interfered with the federal scheme of national "regulation" of the supply, demand and price of high-cost gas by market forces, not FERC or state commission regulation. On its facts, the Court's holding in *Transcontinental* is clear, and clearly not applicable to the present case.

[19]52 Stat. 823; 15 U.S.C. §717c(d).

> ...Except when the Commission permits a waiver, no regulated seller of natural gas may collect a rate other than the one filed with the Commission...(Citation omitted). These straight forward principles underlie the "filed rates doctrine", which forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority. ...
>
> * * *
>
> Not only do the courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively. ...[20]

In its opinion 139-A, the FERC itself considered that it was bound by the filed rate doctrine. The FERC stated:

> ...It is true that we would be prohibited from relieving a company of an improvident contract unless we made a Section 206 finding that rates under the contract were so low as to adversely affect the public interest.... (A.J.S. p. 312a).

On December 2, 1980, the FERC, in Docket ER 81-19-000, accepted the 1971 Agreement as a jurisdictional rate schedule. In the Nantahala wholesale rate case, Docket Nos. ER 76-828 and EL 78-18, the ALJ did not render his initial decision until April 10, 1981. The Full Commission's Opinion 139 was not rendered until May 14, 1982 and Opinion 139-A was not rendered

[20]*Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). See, *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). This argument necessarily assumes that the NFA and the 1971 Agreement establish the wholesale "rate" for a FERC-regulated entity to charge Nantahala for the power which Nantahala sells to its retail customers. As noted above, however, such are not the facts of this case, which further demonstrates the lack of a substantial preemption question here.

The retroactive ratemaking rule could also be applied to prevent FERC action in 1980 from approving an agreement retroactively to 1971 so as to interfere with a state regulatory commission's inquiry as to expenses, etc. in a previously filed retail rate case involving data arising out of a 1975 test year.

until September 30, 1982. Under the filed rate doctrine, if applicable to this case at all, FERC was obliged to abide by the terms of the 1971 Agreement, as filed on December 2, 1980. Yet, the FERC, ***without reforming that Agreement***, set Nantahala's wholesale rates upon a theoretical assignment of 44 million kwh more energy than was allocated to Nantahala under the Agreement!

The United States Court of Appeals in *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342, 1346 (4th Cir., 1984) upheld FERC's theoretical assignment by stating:

> ..Since Nantahala only received 360 million kilowatt hours under the 1971 Agreement, the [Federal Energy Regulatory] Commission reasoned that Nantahala had purchased from TVA 44 million kilowatt hours of energy more than it should have, and these excessive purchases should not have been reflected in Nantahala's rates.[21]

In other words, the scope of the filed rate doctrine is not so extensive as to prevent FERC action inconsistent with a filed rate in setting other wholesale rates.[22]

[21]The Fourth Circuit's opinion affirming FERC's decision was narrowly drawn and turned upon the FERC's broad ratemaking powers under §205 of the Act. As the Court stated: "While...this evidence does suggest a basis for the commission to order rolled-in costing, it does not compel the conclusion that the Commission must, as a matter of law, consolidate costs for ratemaking purposes. A decision to order roll-in is essentially a matter of Commission discretion..." *Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342, 1348 (4th Cir. 1984).

[22]We point out to the Court the difficulty Appellants and their supporting amici have in agreeing among themselves as to exactly what rate level the FERC established as the filed rate. (Compare Appellants' Brief, p. 24, where they seek the filed rate modified by 404 thousand mwh with FERC's Brief, pp. 9, 12, where it speaks of the rate filed with FERC in 1980).

2. *The FERC Did Not Assign Costs For Retail Ratemaking Purposes, Nor Did Its Action Allocate Power Between North Carolina And Tennessee.*

As earlier noted, the NFA was merely a power transformation agreement between Alcoa, Nantahala and Tapoco with TVA, whereby most of Nantahala"s hydroelectric generation and all of Tapoco's hydroelectric generation was, at the instant of production, turned over to TVA. TVA delivered return power entitlements of a type and quantum negotiated by Alcoa to suit its manufacturing operations but not the variable needs of a public load. The NFA was silent as to how the TVA return power was to be divided; instead, such division was left up to all three Alcoa companies. In fact, the NFA treated Nantahala and Tapoco as a combined system. If that agreement fixed costs, which is denied, it certainly did not allocate costs. The 1971 Agreement between Nantahala and Tapoco was a formal division, as between them (with Tapoco standing in Alcoa's shoes), of the power returned by TVA under the NFA.[23]

Neither of the two Agreements fixed or allocated, as between Nantahala and Tapoco, either the costs, revenues, capital requirements, money flow, rates or any other matter of a financial nature. All financial matters remained within the personal domain of each company, subject to Alcoa's ultimate control. Only the 1971 Agreement (which FERC found to be unreasonable and declined to follow) ever purported to assign or allocate power and energy.[24]

[23]Originally, the TVA return power entitlements had been divided by a 1963 Agreement between Alcoa, not Tapoco, and Nantahala which was much more favorable to Nantahala (See Appellees' Motion to Dismiss, pp. 9-10, items 16-18).

[24]It should be noted here that the NCUC's Order found Tapoco to be a North Carolina public utility with service responsibilities in North Carolina. Both Tapoco's state and federal licenses to operate the "Tallassee Project" required Tapoco to make certain power available to serve Nantahala and its customers. See Appellees' Motion to Dismiss, pp. 6, 7, Item 10; A.J.S. p. 25a.

In 1980, in Docket No. ER 81-19-000, when FERC accepted Tapoco's filing of the 1971 Agreement, it did absolutely nothing to fix or allocate either Nantahala's or Tapoco's stand-alone costs, revenues, capital requirements, money flow or any matter of a financial nature. The 1971 Agreement remained exactly what it had been before filing; namely, a power allocation or division as between Nantahala and Tapoco (Alcoa).

In Docket Nos. ER 76-828 and EL 78-18, the FERC examined the NFA and 1971 Agreement, but again it took no action to modify either Agreement so as to affect costs. Indeed, in Opinions 139 and 139-A, the FERC expressly disallowed the wholesale customers" request to modify the Agreements pursuant to the FERC"s authority to do so under Section 206 of the Federal Power Act (A.J.S. pp. 281a, 311a.). Thus, the two Agreements remained exactly as they had always been.

The FERC found the 1971 Agreement to be unfair and unreasonable for wholesale ratemaking purposes (A.J.S. pp. 290a, 293a, 295a, 296a). More importantly, FERC also found that any wholesale rate flowing from the agreement, "...does not constitute a just and reasonable rate." (A.J.S. p. 312a).

Furthermore, FERC found that, by the 1971 Agreement, Nantahala and Tapoco did not sell power to each other. In Opinion 139, the FERC explicitly held that Nantahala and Tapoco "...unlike the companies in the Southern Systems... they do not exchange energy with each other...." (A.J.S. 292a). Without an exchange of power, there can be no sale.

Appellants' argument (stated as a fact) that the 1971 Agreement assigned power as between North Carolina and Tennessee, is also incorrect. The 1971 Agreement expressly allocates power only as between Nantahala and Tapoco, not as between states. Tapoco is not just a public utility with facilities and one customer in Tennessee, it is also a North Carolina public utility (A.J.S., p. 175a) with generating facilities in North Carolina (R.p. 79), holding a North Carolina Certificate of Convenience and Necessity with an obligation to serve the public (R.p. 88). Furthermore, Tapoco is an integral part of the Nantahala/Tapoco unified single elec-

tric public utility system which serves a public load in North Carolina. The 1971 Agreement does not even begin to purport to allocate power as between North Carolina and Tennessee.

3. *The NCUC Is Not Required To Follow FERC'S Ratemaking Methodologies.*

Appellants contend that the filed rate doctrine is so broad as to require a state commission to blindly follow FERC's ratemaking techniques. Thus, the Appellants hypothesize, because FERC specifically declined to pierce the corporate veil, declined to use the roll-in ratemaking methodology, declined to find that Nantahala and Tapoco comprise a single electric system, and declined to find that Tapoco is a North Carolina public utility, the NCUC could not make contrary findings. This is not a correct statement of ratemaking law.

Courts have repeatedly recognized that Federal and State regulatory commissions can adopt different ratemaking methodologies. *Mid-Tex Electric Cooperative, Inc. v. FERC, supra.* In *Public Systems v. FERC*, 709 F.2d 73, 84 (D.C. 1983), a FERC case dealing with tax allowances for rate setting, the Court said:

> There are many differences between the principles the state and federal commissions may utilize in setting wholesale rates. A given state may treat rate of return, *cost allocation*, rate base valuation, and normalization differently than the FERC (Emphasis supplied).[25]

Upon the appeal of FERC Opinions 139 and 139-A, in *Nantahala Power and Light Co. v. FERC, supra* 727 F. 2d at 1351, the Fourth Circuit Court stated:

[25]See also 16 U.S.C. §825(a). States can adopt different systems of accounts and depreciation schedules.

> Nantahala argues that the Commission's refusal to acknowledge a finding of fact of the North Carolina Utilities Commission that Nantahala had not recovered all costs of its wartime facilities and its placing the burden of proof on this issue upon Nantahala constituted reversible error....The North Carolina Utility Commission's approval (in 1975) of Nantahala's restatement of depreciation is clearly not binding on the FERC. Its decision was based on its assessment of the evidence. The Commission is clearly entitled to make its own assessment of the evidence before it.

In Opinion 139, the FERC also declined to follow the NCUC's finding that Tapoco was a North Carolina public utility stating:

> We note that subsequent to the hearings and briefing of this case, but prior to the initial decision, the North Carolina Utilities Commission issued a decision finding that Tapoco is a public utility under North Carolina law. However, the definition of "public utility" in North Carolina is peculiar to that state and not determinative of the issues to be decided here (A.J.S. p. 293a, footnote 21).

Of even greater significance is the fact that in Opinion 139-A, the FERC expressly acknowledged that the NCUC, applying State criteria, could validly require roll-in:

> We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant (A.J.S. p. 305a).[26]

[26]The suggestion of the Solicitor General in his brief (p. 19, footnote 12) that the quoted language from Opinion 139-A was no more than a "casual remark"

Keeping in mind that the roll-in is a cost allocation technique, FERC's recognition of the NCUC's independence was correct and in line with the quoted language of *Public Systems v. FERC*, *supra*, that states are free to use their own cost allocation methodology.

B. The Filed Rate Doctrine Permits States To Determine Whether FERC-Approved Costs Are To Be Borne By Stockholders Or By Ratepayers.

A line of developing cases holds that, even if FERC has allocated a particular cost to a particular state or local utility, a state commission retains the right to determine whether such FERC-allocated cost, even though reasonable as between the wholesale utility and the retail utility, should be borne by the retail utility's ratepayers or by its stockholders. Not only may the state commission choose whether to pass such costs on to the retail ratepayers or to impose such costs on the shareholder(s) of the retail utility, it may determine the timing or the incidence of such costs.

The essence of this developing rule is aptly expressed in *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 699 (N.H. 1985), wherein it is observed:

> The PUC correctly determined under federal preemption principles that FERC approval of a wholesale rate precludes the PUC from questioning the *reasonableness of that charge*. However, it does not follow *automatically* that the PUC must find that power costs incurred under a wholesale rate are *necessarily* a *reasonable expense for the retailer*. ...(Emphasis supplied.)

(Footnote Con't)

by FERC, clearly conflicts with the context in which FERC made this ruling. In the FERC proceeding, Appellees had lodged the NCUC opinion at FERC and had argued that FERC should follow the NCUC single-system, roll-in determination. The ALJ declined to do so ("To remedy this situation, it is not necessary to pierce the corporate veil..." A.J.S. p. 275a). In affirming the ALJ on this point, FERC explicitly acknowledged the NCUC's right to reach a different conclusion based on "...criteria which [the NCUC] may deem relevant." (A.J.S. p. 305a).

Similarly, in *Public Service Co. of Colorado v. Public Utilities Comm. of Colorado*, 644 P.2d 933 (Colo., 1982), the Colorado Supreme Court reviewed an order of the Colorado PUC holding that FERC-approved costs of participation in the Gas Research Institute ("GRI") need not be passed through automatically to consumers. The Court concluded that the Colorado PUC had the authority to scrutinize such costs in a general retail rate case ". . . to balance the interests of utility investors and the ultimate consumers in arriving at a just and reasonable rate. . ." (644 P.2d, at 944) and affirmed the PUC.

Washington Gas Light Co. v. Public Service Comm. of the District of Columbia, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983) is similar. The Court reversed the D.C. Commission, however, because it found that the Commission's decision, regarding the flow-through of GRI expenses into retail rates, was based on the preempted conclusion that the wholesale increase was unreasonable, not on the permissible conclusion that a portion of such increase should not be passed along to the ratepayers in retail rates.

In the *Sinclair* case, *supra*, Connecticut Valley Electric Company ("Connecticut Valley") filed a general retail rate increase, based upon an increase in the wholesale rates which it paid to its power supplier, Central Vermont Public Service Corporation ("Central Vermont"). Connecticut Valley was a wholly-owned subsidiary of Central Vermont. Pursuant to a unilateral settlement agreement proposed by Central Vermont, FERC approved the wholesale rates charged by Central Vermont to Connecticut Valley. Such rates included a pass-through of Central Vermont's cost of two abandoned nuclear plants. Inclusion of these costs in Connecticut Valley's retail rates was challenged by the consumers on the basis of New Hampshire's "anti-CWIP" statute. The New Hampshire PUC held that it was required to automatically flow 100% of the settlement agreement rate into retail rates

The New Hampshire Supreme Court reversed, holding that, while the preemption (filed rate) doctrine precluded the PUC from disapproving the wholesale rate (despite the state's anti-CWIP statute), the PUC was free to inquire into the reasonableness of Connecticut Valley's purchases from Central Vermont, in light of other purchase options available. The case was remanded to the PUC to make this inquiry. The Court observed:

> The central question before the PUC in a retail rate case such as this is whether costs incurred under a wholesale rate, which has been approved as being a just and reasonable *charge* by the wholesaler, are just and reasonable *operating expenses* of the retail utility .... The PUC never reached this question (Emphasis supplied by the Court). *Sinclair, supra*, 498 A.2d 696, 699.

Accord, Pike County Light and Power Co. v. Pennsylvania Public Utility Commission, 77 Pa. Commw. Ct. 268, 465 A.2d 735 (1983).

There is a similarity between the NCUC's roll-in and the Colorado and New Hampshire cases if Nantahala were assumed to be a "stand-alone" utility. Viewed this way, the NCUC merely determined that some of Nantahala's so-called "stand-alone" costs were improper, with respect to retail ratepayers, and that such costs should be borne by the stockholders for whose benefit they were incurred.

Following a discussion of the above line of cases, the North Carolina Supreme Court approved the principle of shifting costs to the stockholder, that had not been incurred for the ratepayers' benefit, using this language:

> ...the Commission determined that one of the most fundamental of the concealed benefits flowing to Alcoa under the NFA was the trading away of hydroelectric capacity suitable for serving a public load, at a time of sustained growth in that load, in return for entitlements structured to be of far more value for aluminum smelting than for public service.

> Accordingly, the Commission determined that to the extent that Alcoa had caused Nantahala to trade capacity and energy suitable and usable for serving its public load, the costs associated with that trade-off would be borne by Alcoa and not by the retail ratepayers who lost the benefit of these resources and facilities of Nantahala through intercorporate transactions over which they had no control. This determination lies well within the sphere of state regulatory authority delineated in the *Narragansett-Northern States* line of cases relied upon by the companies in support of their preemption arguments (313 N.C., *supra* at p. 701).

Fundamental to such a cost shift in the current case are the circumstances of corporate abuse present between Nantahala and its parent, Alcoa.[27] The facts found below demonstrate that the historical development of the Alcoa Power System, including Nantahala and Tapoco, is unique in the electric power industry and cannot properly be compared to other, traditional electric utilities.[28]

Any argument by Appellants that this recent line of developing cases and the resultant shifting of cost responsibility to the stockholder are inappropriate here, on grounds that the various

[27]The NCUC stated in its opinion: "The Commission must conclude that Alcoa has so dominated these transactions and agreements affecting its wholly-owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interests of its public utility customers in North Carolina."; and "...Alcoa's dominance over its wholly-owned subsidiaries Nantahala and Tapoco during the course of the New Fontana negotiations has resulted in substantial benefits to Alcoa and significant detriment to the customers of Nantahala." (A.J.S. p. 233a).

[28]Alcoa tried to dispose of Nantahala's distribution system (and, thus, its load responsibility in North Carolina), by a sale of Nantahala's distribution system, but not any of Nantahala's major hydrogeneration resources, to Duke Power Company. The low cost hydropower from Nantahala's remaining generation system would have then been 100% available to Alcoa. Alcoa was prevented from such abandonment of its public load responsibility by a decision of the North Carolina Supreme Court. *Utilities Commission v. Membership Corporation*, 260 N.C. 59; 131 S.E. 2d 865 (1963).

commissions in the cited cases merely diminished profitability, whereas, in this case, the roll-in resulted in actual losses to Nantahala, is invalid. Nantahala is protected from any loss by the requirement that Alcoa make refunds.

In a later Nantahala retail case, recently remanded to the NCUC for further consideration, the North Carolina Supreme Court said of the Alcoa refund obligation:

> In its two previous orders implementing a roll-in ratemaking methodology, the Commission has not hesitated to place financial responsibility upon Alcoa for any portion of Nantahala's refund obligation which Nantahala is itself unable to pay while continuing to render adequate service to its customers. The relief ordered by the Commission, and affirmed by this Court, in the two prior rate cases is essentially the same relief sought by the intervenors in this case. There is no principal distinction between a refund financed by Alcoa to rate payers on the basis of excessive rates charged by Nantahala over a historic period, and a periodic payment by Alcoa to Nantahala for any current or future revenue shortages on Nantahala's books which may result from prospective rolled-in rates. Both forms of relief are merely anciliary to the establishment of a just and reasonable rate schedule as approved by the Commission for Nantahala. *Utilities Commission v. Edmisten*, 314 N.C. 122, 161; 333 S.E. 2d 453 (1985).

II.

THE NCUC'S USE OF THE ROLL-IN METHODOLOGY IN SETTING NANTAHALA'S NORTH CAROLINA RETAIL RATES IS NOT BARRED BY THE COMMERCE CLAUSE OF THE UNITED STATES' CONSTITUTION.

A. The Roll-In Is Outside Of The NEPCO Prohibitions.

Appellants contend that the roll-in grants an unconstitutional preference to Nantahala's North Carolina customers over Tapoco's Tennessee customer (Alcoa) in violation of the Commerce Clause of the United States Constitution (Art. I, §8, Cl. 3), as interpreted by this Court in *New England Power Co. v. New Hampshire*, 455 U.S. 331, (1982), hereafter "NEPCO".

Appellees fully recognize that NEPCO lays down a proper interpretation of the Commerce Clause in holding that a state utilities commission cannot give its citizens a preferential or exclusive right to the hydroelectric energy (or any other natural resource) produced in its state, and that the grant of such a preference or exclusive right places a direct and substantial burden on interstate commerce.

Clearly, a power preference has not been created by the roll-in. First, the roll-in did not, in any manner, deal with power and did not allocate Nantahala any power that it did not receive under the NFA and the 1971 Agreement. Rather than power, the roll-in allocated costs. Since the roll-in is based on the fact that Nantahala and Tapoco comprise a single electric public utility system, the roll-in merely allocated a fair percentage of the total single system's costs to Nantahala's retail customers. *This procedure was used only for purposes of setting Nantahala's retail rates.* The roll-in did not go beyond the NCUC's exclusive retail ratemaking functions, so as to allocate some of Tapoco's power to Nantahala, nor did it attempt to reform either the NFA or the 1971 Agreement. In addition, the roll-in does not mandate or affect the rate by which Tapoco sells power to Alcoa.

In NEPCO, the New Hampshire Commission attempted to insulate its protectionist order by implementing an accounting technique whereby the hydroelectric generation could actually flow out-of-state, but costs were to be calculated as if the power did not flow out-of-state. Methodology aside, however, the New Hampshire Commission enforced a state statute whose sole pur-

pose was to restrict the flow of local power generation and prevent it from flowing out-of-state. The applicable North Carolina statutes contain no such restriction, either as written or as applied by the NCUC.

This Court described the protectionist action of the New Hampshire Commission with this language:

> ...The order of the New Hampshire Commission, prohibiting New England Power from selling its hydroelectric Energy outside the State of New Hampshire, is precisely the sort of protectionist regulation that the Commerce Clause declares off-limits to the states. The Commission has made clear that its order is designed to gain an economic advantage for New Hampshire citizens at the expense of New England Power's customers in neighboring states. (455 U.S. at 339)

There is an enormous between the protectionist action of the New Hampshire Commission, which, for all practical purposes, blocked hydroelectric power from flowing out-of-state, and the action of the NCUC in determining that the properties and plants of Nantahala and Tapoco constitute a single electric public utility system and allocating to Nantahala's retail load its proper share of the total costs of that single system. New Hampshire's act was intended to bar the flow of power out of state, while the NCUC's act was simply to set just and reasonable rates for the North Carolina retail customers of a single electric public utility system operating in more than one state. The roll-in is not a technique by which the NCUC has attempted to "lock the door" to keep Nantahala's power from flowing out-of-state or to "grab" some of Tapoco's power generation for the exclusive benefit of North Carolina retail ratepayers. To the contrary, the roll-in is no more than a traditional cost allocation methodology applied to a single utility company, operating in more than one state, with both retail and wholesale loads. As a consequence, the NEPCO doctrine does not fit the facts of the present case.

If applicable at all, NEPCO approves rather than forbids the NCUC's roll-in methodology. That is to say, Alcoa and its allies (particularly the State of Tennessee) seek a protectionist order which would be NEPCO in reverse. They seek a result which requires that *all* not merely some) of Tapoco's power from its North Carolina facilities at Cheoah and Santeetlah be exported to Tennessee, while, at the same time, requiring that *none* of Tapoco's power from its Tennessee facilities at Chilhowee and Calderwood be allowed to leave Tennessee. It is Alcoa and its allies, not the Appellees, who are arguing in favor of economic protectionism.

To support their protectionist argument, the Appellants rely heavily on a misstatement in the NCUC order that the North Carolina public load had a "first call on the total electric energy output of the combined system" (A.J.S., p. 183a). Appellees believe that the most cogent response to this argument is the analysis of the North Carolina Supreme Court:

> ...Nowhere does the Commission's discussion or application of the roll-in methodology actually implement a "first call" concept. The Commission has not granted North Carolina customers a preference to the economic benefits of hydroelectric energy generated in North Carolina at the expense of Alcoa in Tennessee, it merely eliminated from Nantahala's existing rate structure preferences and inequities which were effectuated in the past by basing Nantahala's rates on the fiction that it was a stand-alone company. This traditional exercise of its ratemaking authority is simply not proscribed by the rule established in NEPCO, or in other Commerce Clause cases (313 N.C. at 715; A.J.S., p. 103a).

B. *Any Economic Benefit Which Indirectly Flows From The Roll-In Is Permissible Under The Bruce Church Doctrine.*

Appellants contend that the roll-in methodology was designed or intended to gain an economic advantage for North Carolina, at the expense of Tennessee, which is an impermissible burden on interstate commerce. Alcoa argues that it, as a *customer* of Tapoco, is penalized and the State of Tennessee argues that, as a result, Alcoa will close its Tennessee Operations, resulting in economic chaos. Both arguments are invalid.

We first point out that, during the 1975 test year, Nantahala's entire public load for approximately 29,000 customers was slightly in excess of 450 million kwh (Nantahala generated in excess of 560 million kwh in 1975; 313 N. C. 614, p. 644; A.J.S., p. 32a). By contrast, during that same year the Alcoa, Tennessee plant consumed 3.15 billion kwh (1,365,499,000 kwh purchased from Tapoco and 1,784,833,000 kwh purchased from TVA; 313 N.C. 614, at p. 638; A.J.S., p. 26a). Thus the Alcoa, Tennessee plant alone consumed seven times the amount of power that all of Nantahala's 29,000 retail customers consumed. The Alcoa, Tennessee plant consumption would have served some 203,000 customers of the average size of Nantahala's 29,000 (See, A.J.S., p. 215a).

Appellees point out that Alcoa has informed its stockholders that the Alcoa, Tennessee plant is currently being modernized[29] and has also reported to the Securities and Exchange Commission that such modernization has "gained momentum."[30]

The above matters are pointed out to refute the Appellants' alleged, but unproven, agrument that the roll-in somehow gives North Carolina customers an economic advantage with respect to Alcoa as a customer of Tapoco. We have previously refuted that assumption by showing that the roll-in imposes a financial obligation on Alcoa solely because of its status as the dominating, North Carolina public utility parent of Nantahala, not because of its status as "Tennessee citizen" or "Tapoco customer". The roll-in allocates only average single system costs, including the average single system cost of power. No preferences are award-

[29]Alcoa, Annual Report, 1984 (March 8, 1985), pp. 1, 11-12, 13.

[30]Alcoa SEC Form 10K (fiscal year ended December 31, 1984; Commission File Number 1-3610), p. 21.

ed to or detriments imposed upon any customer (or class of customer) of the single system.

Despite the foregoing, Appellants contend that the "...NCUC order epitomizes the kind of state interference with interstate commerce that the Commerce Clause was intended to prevent." (Brief p. 34). In contrast to such assertion, and in complete answer thereto, Appellees cannot improve upon the language of the learned Justice Meyer, of the North Carolina Supreme Court, where he said (A.J.S. pp. 103a-105a):

> It is well settled in modern commerce clause jurisprudence that the existence of a commerce clause violation depends in any case, upon 'the nature of the state regulation involved, the objective of the state and the effect of the regulation upon the national interest in the commerce.' *Illinois Natural Gas Co. v. Central Illinois Pub. Serv. Co.*, 314 U.S. 498, 505, 86 L.Ed. 371, 376. The Supreme Court recently reformulated the basic test to be applied as follows: 'Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. (Citation omitted.) If a legitimate local purpose if found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a less impact on interstate activities.' *Pike v. Bruce Church*, 397 U.S. 137, 142; 25 L.Ed.2d 174, 178 (1970).
>
> In *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n*, 461 U.S. 375, 76 L.Ed.2d 1, the Court applied the Bruce Church test to the question of whether state public service commission regulation of wholesale electric rates charg-

ed by a rural power cooperative to its member retail distributors was forbidden by the Commerce Clause of the United States Constitution. The Court upheld such "even-handed" regulation, reasoning that (l) economic protectionism is not implicated by the traditional rate making functions of the state public service commissions; (2) state regulation of wholesale rates charged by a rural power cooperative is well within the scope of 'legitimate local public interest,' particularly where the cooperative's basic operation consists of supplying power from generating facilities located within the state to member cooperatives, despite the fact that the cooperative is also tied into an interstate power grid; and (3) the effects on interstate commerce of state regulation of wholesale rates the cooperative charges its members are only incidental, so that the burden imposed on such commerce is not clearly excessive in relation to the putative local benefits.

In passing, the *Arkansas Electric* Court observed that despite the fact that most retail utilities receive a portion of the power they sell from out-of-state, "[T]he national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States. Similarly, it is true that regulation of the prices AECC [the cooperative] charges to its members may have some effect on the price structure of the interstate grid of which AECC is a part. But, again, we find it difficult to distinguish AECC in this respect from most relatively large utilities which sell power both directly to the public and to other utilities.

The NCUC's decision addresses matters of strong, legitimate local interest and purpose. The roll-in rates charged by Nantahala to its retail customers, and any conceivable impact thereof on Tapoco, Alcoa or TVA, could only have a *de minimis* or inciden-

tal effect on the price structure of the interstate grid of which Nantahala is a part. Any such incidental effect is clearly not excessive in relation to the substantial local interest in the NCUC's establishment of just and reasonable electric rates for Nantahala's North Carolina retail customers. If the roll-in did, somehow, touch upon interstate commerce, which is denied, the intrusion served a legitimate local public interest with only indirect and negligible effects on such commerce. Accordingly, *Bruce Church* allows such action.

CONCLUSION

Application of the specific and unique facts of this case to the federal preemption (filed rate) doctrine and to the Commerce Clause of the United States Constitution establishes that the roll-in applied by the NCUC does not encroach upon either FERC's exclusive jurisdiction over interstate power flows and wholesale electric rates or upon interstate commerce. Not only is the NCUC action outside of the preemption doctrine, it is a part of the NCUC's proper and lawful ratemaking responsibility to determine fair and reasonable retail intrastate rates.

Over 30 years ago, Justice Barnhill of the North Carolina Supreme Court (concurring) in *Utilities Commission v. Mead Corp.*, 238 N.C. 451, 465-468; 79 S.E.2d 290 (1953) correctly described the Nantahala/Alcoa relationship this way:

> ...If they (the NCUC) will only cut through the form to the substance, they will find just another hydroelectric power producing agency of Alcoa, retailing just enough of its production - less than 20% - to permit it to pose as a quasi-public corporation with the right to use the water power resources of this State, exercise the power of eminent domain, and enjoy the other monopolistic privileges accorded a public utility while it was, in fact, created and exists primarily to serve its master which seeks and must have low-cost hydroelectric power.

* * *

...Seldom indeed is a situation such as the one disclosed by this record brought to light in the course of litigation or otherwise. I am certain its parallel does not exist in this State.

Alcoa's flagrant manipulation of its power-producing subsidiaries, described by Justice Barnhill, continues to this day. It is this manipulation which has necessitated the NCUC's order and the roll-in methodology utilized by the Commission in setting fair and reasonable retail rates.

Accordingly, the decisions of the NCUC and the North Carolina Supreme Court are well founded and should be affirmed.

Respectfully submitted, this 21st day of February, 1986.

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APPENDIX

APPENDIX

NORTH CAROLINA GENERAL STATUTES

§62-3. Definitions.

(23) c. The term "public utility" shall include all persons affiliated through stock ownership with a public utility doing business in this State as parent corporation or subsidiary corporation as defined in G.S. 55-2 to such an extent that the Commission shall find that such affiliation has an effect on the rates or service of such public utility.

§62-133. How rates fixed.

(b) In fixing such rates, the Commission shall:

(1) Ascertain the reasonable original cost of the public utility's property used and useful, or to be used and useful within a reasonable time after the test period, in providing the service rendered to the public within the State, less that portion of the cost which has been consumed by previous use recovered by depreciation expense plus the reasonable original cost of investment in plant under construction (construction work in progress). In ascertaining the cost of the public utility's property, construction work in progress as of the effective date of this subsection shall be excluded until such plant comes into service but reasonable and prudent expenditures for construction work in progress after the effective date of this subsection may be included, to the extent the Commission considers such inclusion in the public interest and necessary to the financial stability of the utility in question, subject to the provisions of subparagraph (b)(4a) of this section.

(2) Estimate such public utility's revenue under the present and proposed rates.

(3) Ascertain such public utility's reasonable operating expenses, including actual investment currently consumed through reasonable actual depreciation.

(4) Fix such rate of return on the cost of the property ascertained pursuant to subdivision (1) as will enable the public utility by sound management to produce a fair return for its shareholders, considering changing economic conditions and other factors, as they then exist, to maintain its facilities and services in accordance with the reasonable requirements of its customers in the territory covered by its franchise, and to compete in the market for capital funds on terms which are reasonable and which are fair to its customers and to its existing investors.

(4a) Require each public utility to discontinue capitalization of the composite carrying cost of capital funds used to finance construction (allowance for funds) on the construction work in progress included in its rate based upon the effective date of the first and each subsequent general rate order issued with respect to it after the effective date of this subsection; allowance for funds may be capitalized with respect to expenditures for construction work in progress not included in the utility's property upon which the rates were fixed. In determining net operating income for return, the Commission shall not include any capitalized allowance for funds used during construction on the construction work in progress included in the utility's rate base.

(5) Fix such rates to be charged by the public utility as will earn in addition to reasonable operating expenses ascertained pursuant to subdivision (3) of this subsection the rate of return fixed pursuant to subdivisions (4) and (4a) on the cost of the public utility's property ascertained pursuant to subdivision (1).